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C O N F I D E N T I A L SECTION 01 OF 03 TUNIS 001101

SENSITIVE
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STATE FOR EEB
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STATE FOR NEA/MAG (NARDI AND HAYES)
STATE PASS USTR (BURKHEAD) AND USAID (MCCLOUD)
STATE FOR G/OES
USDOC FOR ITA/MAC/ONE (NATE MASON), CLDP (TEJTEL AND
MCMANUS)
USDOC PASS USPTO (ADAMS, BROWN AND MARSHALL)
CASABLANCA FOR FCS (ORTIZ)
CAIRO FOR FINANCIAL ATTACHE (SEVERENS)
LONDON AND PARIS FOR NEA WATCHER

E.O. 12958: DECL: 10/16/2018
TAGS: ECON EFIN ETRD TS
SUBJECT: TUNISIA PROJECTS CONFIDENCE THAT IT WILL WEATHER
ECONOMIC CRISIS -- BUT CHALLENGES LOOM

REF: TUNIS 00052

Classified By: Ambassador Robert F. Godec for Reasons 1.4 (b) and (d).

Summary

¶1. (U) In the face of worldwide economic volatility, the GOT is boasting about the Tunisian economy's resilience to the crisis. Most often cited reasons for Tunisia's buoyancy include the non-convertibility of the Dinar, lack of global integration, regulations prohibiting Tunisian banks from investing in financial instruments, and restrictions on foreign portfolio investments in the local stock market. Despite government claims to the contrary, clouds loom as exporters confirm declining sales and predict lay-offs, while worried portfolio investors pull their money out of Tunindex. Embassy interlocutors list exports, tourism, and foreign direct investment, pillars of Tunisia's economic growth strategy, as the most likely victims of the crisis. End Summary.

GOT Projects Calm

¶2. (SBU) Against the backdrop of the current financial crisis, GOT leaders have been publicly congratulating themselves for restrictive economic policies that have allowed the economy to weather the storm. The non-convertibility of the Dinar, coupled with restrictions on portfolio investments, has largely kept foreign investors out of the Tunisian stock market. Additionally, restrictions on securitization of debt and Tunisian bank investment in foreign financial instruments have sheltered the financial sector from the sub-prime debt effect troubling other markets. Even so, Tunisian exporters are already taking a hit, and economic jitters resulted in a seven percent tumble of the stock market on September 17. Since the Tunindex's initial decline there has been limited volatility, until October 15 when it declined 12 percent. In response, President Ben Ali and other senior government officials have regularly appeared in the local press to assuage concerns and

curb investor concerns about the potential impact the crisis will have on Tunisia.

¶3. (SBU) On October 10, President Ben Ali announced that he was forming a special advisory committee to monitor economic conditions. That committee is comprised of:
- Taoufik Baccar, the Central Bank Governor;
- Mohamed Nouri Jouini, the Minister of Development and International Cooperation;
- Mohamed Rachid Kchich, the Minister of Finance;
- Afif Chelbi, the Minister of Industry, Energy and Small and Medium Sized Enterprises;
- Mongi Safra, Presidential Advisor;
- Hedi Jilani, the President of the Employers' Union (UTICA);
- Ridha Chalghoum, the President of the Council on Financial Markets; and
- Moncef Ben Slama, professor of economics.

In addition, Central Bank Governor Taoufik Baccar sought to reassure the market by publicly explaining that no more than 25 percent of investment in the Tunis Bourse is foreign. Furthermore, he praised recent decisions by the GOT to extend the mortgage lending period from 15 to 25 years and reaffirmed that mortgage interest rates are fixed to protect Tunisian borrowers from soaring rates.

¶4. (U) The GOT has gone one step beyond self-congratulation, asserting that Tunisia may come out of this crisis a winner. Minister of Employment and Professional Integration of Youth Slim Tlatli recently told the French Ambassador that, by positioning itself as a safe haven for investors seeking calmer waters, Tunisia could benefit from increased

investment over the medium term. In addition, early on as the crisis unfolded, the state-controlled press praised the GOT for successfully predicting the downturn in foreign markets and for making prudent economic policy decisions in response.

If I say It, It is True, Or Not

¶5. (C) Privately, however, some GOT officials are beginning to share their concerns that all is not well in the Tunisian economy. The French Minister of Cooperation, who recently visited, found his Tunisian interlocutors "worried," among other things about whether French assistance would be decreased as a result of the financial crisis. Nejib Karafi, the Director General of the Tunisian Center for Textile Technology (CETTEX) expressed concern to EconOff about textile exports. (Note: Karafi explained that the GOT is working out a way to provide stop-gap loans to Tunisian textile manufacturers as mainly European buyers increasingly request longer repayment periods, sometimes exceeding the 90-day industry average. This effort to support the textile industry, according to financial consultant Ezzedine Saidane, precedes this financial crisis and is illustrative of the troubles in the Tunisian textile industry.)

Not If, But When

¶6. (C) There is no doubt that the economic crisis is affecting Tunisia's real economy. While the Tunisian economy is largely shielded from the financial sector aspects of the crisis, it is most susceptible in the short term to negative impacts in its export-dependent industries. In the short to medium term, its tourism sector may also suffer, and, over the longer term, foreign direct investment may fall off. A recent conversation with the managing director of Johnson Controls, which exports automotive parts to European automakers, revealed that orders from Europe have declined 25 percent since the crisis began. The head of Lear Automotive,

another US subsidiary parts manufacturer, confirmed the trend; orders from his European clients are down by 20 percent for the coming three months. He is certain that he will have to lay-off workers. Paul Garcia, the general manager of Crown Maghreb Can S.A., a subsidiary of Crown Holdings in the US, explained that he has suspended taking orders for 2009, attributing aluminum price fluctuations as the principal reason.

Cracks In the Pillars of Economic Growth

¶7. (C) Exports, tourism, and foreign direct investment are the focus of GOT efforts to maintain 5.1 percent annual GDP growth in 2008. (Note: The GOT's 11th five year economic development plan targets annual GDP growth at 6 percent. On October 8, a a Ministerial Council meeting reduced the projection.) Several Embassy interlocutors, including Ezzedine Saidane, concur that it is precisely these sectors that are at greatest risk. He explained that the economic downturn in Europe during the last two consecutive quarters negatively affected Tunisian exports, a trend that will only worsen in light of recent events. Saidane also stated that with Europe's recession, comes declining European family purchasing power, which may affect tourism.

¶8. (C) Saidane and Michael Smith of Fidelity Investments, concurred that foreign direct investment (FDI) will assuredly slow down. Smith highlighted the negative impact that falling petroleum prices will likely have on the US $60 billion in various real estate development projects (reftel) proposed by various Gulf entities. As Gulf investors come under pressure, they may delay or even cancel investments the

GOT is counting on. Further compounding Tunisia's challenges, its banking sector is already weak and carrying too many non-performing loans. It is not well placed to ramp up lending to compensate for falling foreign investment. Lastly, commentators believe the continued volatility in the Tunisian stock exchange is illustrative of the psychological impact the crisis is having on investors, which when coupled with an ever tightening lending tendencies by Tunisian banks, signals continued challenges for business development and expansion in the last quarter of 2008 or beyond.

Comment

¶9. (SBU) This crisis does not bode well, in part because Tunisia is dependent on exports and tourism for hard currency income. It is also dependent on foreign investment for continued strong economic growth. Moreover, a slowdown in the economy will increase existing unemployment, which helped lead to unrest in the Gafsa region earlier this year. If the GOT wants to make good on its aspiration to come out of this crisis a winner, it must make investing in Tunisia easier and more attractive. In a crisis, it can be easier for a government to pass reforms. The question is whether the GOT is willing to take the difficult steps, for example, of liberalizing its services sector. In addition, continued efforts to clean up the banking sector are needed more than ever to motivate domestic investment and bolster investor confidence.

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